RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

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Dec. 31 DJIA 1938.83; PTI 2612; A-D Ratio -12.20
Jan. 8 DJIA 1911.31; PTI 2636; A-D Ratio -11.45
Current Dow Yield: 3.62%; Dow P/E: 13.8
Dow 200-day mov aver: 2299

LETTER 982

THE PICTURE: The single operative fact for investors today is that we are in a primary bear market. But people seem to forget this, so I'll start the Letter as follows (even though I've said it all before): (1) Bear markets exist for the purpose of correcting the excesses of the preceding bull market. (2) The bear wants one thing above all — he wants to decline while taking as many investors with him as possible. (3) In order to destroy as many investors as possible, the bear must be **deceptive,** and the bear must offer **hope.** The deception occurs during bear market rallies, and the hope, of course, is that each rally will turn out to be "a new bull market." (4) The bear also knows how to turn investors' own emotions against them. The emotions the bear likes to deal with are **greed** and **impatience.** Greed makes people buy bear market rallies, and impatience prevents them from waiting for the next primary bull market.

On October 15 a primary bear market was signaled under Dow Theory. On October 19 the stock market crashed with a thunderous roar heard 'round the world. I labeled that crash as the greatest and most dramatic trend reversal in the history of Wall Street (greatest both in terms of Dow points lost and in terms of volume). If there existed any doubt about this being a bear market, I wrote, the crash should have eliminated that doubt.

Ironically, only a few months after the crash (by December and January) the prevalent talk was of "good retail sales," "a healthy rally on Wall Street," "a bright outlook for the economy," and "the birth of a new bull market."

To review the post-crash price action: Two days after the crash (on October 21) the Averages rallied, Industrials to 2027.85 and Transports to 787.01. Next, the market sold off to re-test the crash lows. On December 4 the Transports broke to a further bear market low of 661.00 -- but the Industrials did not confirm.

The non-confirmation set off a new advance with the target for the Averages being the October 21 highs or 2027.85 and 787.01. On January 5 the Dow bettered the 2027.85 peak. Two days later, on January 7, the Transports confirmed by bettering their comparable high of 787.01. The market "should have" rallied from there.

What happened next provides the perfect example of why I have asked my subscribers to refrain from trying to scalp the market (i.e., trying to"beat the bear"). On the next day the Dow dropped 140 points accompanied by a smash in the Transports of 44 points. The January 8 drop was the third greatest in Wall Street history.

Only two items in my collection of technical indicators suggested the drop: (1) The huge head-and-shoulders pattern now visible in the Dow, and (2) the dramatically poor action of my proprietary index, **DowPow** (see later section). However (and I'll probably be repeating this ad nauseum), **this is a bear market and it's out to separate the players from their bankrolls.**

Question: Russell, are you telling us that the joint breakout of the Industrials and Transports above the October 21 highs was a fake-out?

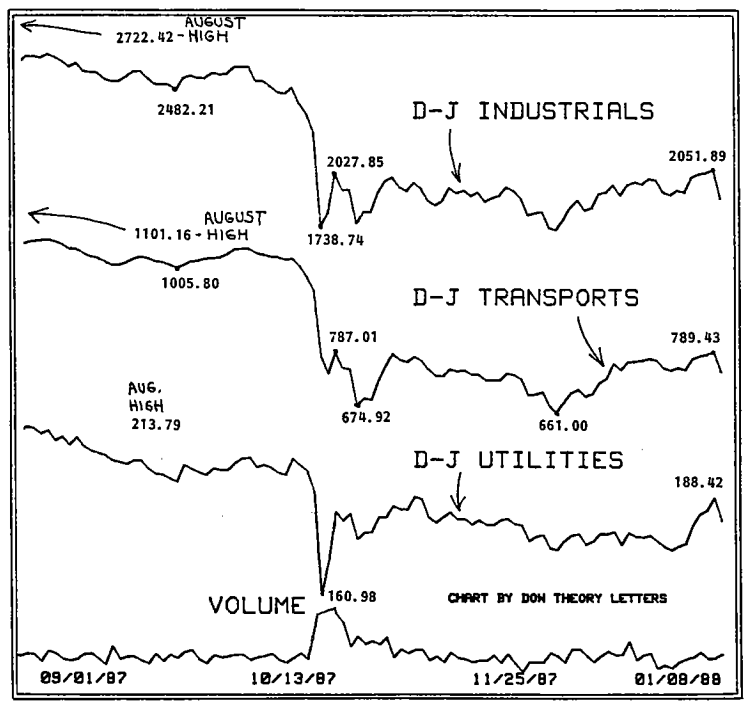
Answer: This is a tough time to write a Letter, but as I've often said, they don't run the New York Stock Exchange for Richard Russell. I can't tell or guess what will happen next month or even next week, but on the face of it, yes, it does appear as if the bear used the bettering of the October 21 highs as a deceptive device to lure traders into his lair. But please, don't be surprised -- we'll see a lot more of this kind of deceptive action before this bear market breathes its last.

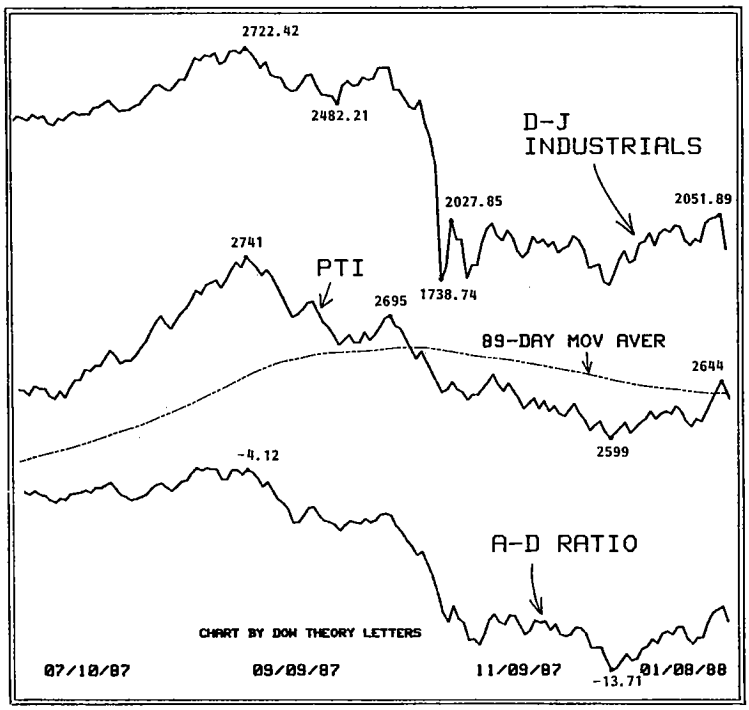
Question: Russell, what about the automatic 50% recovery of the bear market losses which you said follows every crash?

Answer: Nothing is certain in the stock market except that bull markets go up and bear markets go down. I had advanced the 50% post-crash recovery thesis in two *Barron's* articles, the first appearing on October 19 and the second appearing on October 26. Barron's boasts a circulation of a quarter of a million, and it is read by almost every serious investor and analyst in the nation. Consequently, many of these people quickly picked up the 50% recovery concept. The stock market hates to have its intentions advertised in advance. Therefore, I caught myself wondering whether the market wouldn't cross us up on the 50% retracement thesis -- cross us up in that the Dow would either not rise as high as 2200 (a figure which would have recouped half of the bear market losses) or that the Dow would rise well above the 2200 level. Judging by the way the market has acted so far, it's certainly possible that the recovery will be sub-normal in extent.

Question: Russell, when you discuss figures on the D-J Averages, are you talking about closing figures?

Answer: Yes, always. A long study of market action has convinced me and other Dow Theorists that intra-day figures can be interesting, but they can also be very deceptive. The final closing figures are the ones that show what the market did minus the rumors, manipulations, and excitement of the trading day. Most importantly, the closing figures show how the market fared after





the traders have closed out their intra-day positions. The final figures, in other words, are what investors, traders, insiders, and outsiders are willing to go to sleep on.

Question: Could we be in a new bull market?

Answer: This is a question I'm asked repeatedly these days. The market can do anything, and anything is possible. But in my opinion it will be a long time before we see a new primary bull market. I have stressed the "automatic recovery" aspect of post-crash action for just this reason -- the reason being that I knew when the upside action finally came, it would be greeted by many as "a new bull market."

Remember this: Wall Street does not make money in a bear market. Wall Street makes money when the trend is up and the bull is rampaging to the north. Thus, Wall Streeters (following numerous brokerage house consolidations, mergers, and mass firings) are fairly drooling at the thought of a new bull market (and honestly, who can blame them). Furthermore, the spokesmen for Wall Street feel heavy pressure on themselves to talk bullishly and think optimistically. There are jobs at stake here. As the market goes down, so does Wall Street employment. (Note: The estimate is that since October 19 Wall Street firms have laid off 20,000 people.)

Question: Russell, during the pre-crash period last year you constantly wrote about the dangerously low Dow yield? How does the yield situation stack up now?

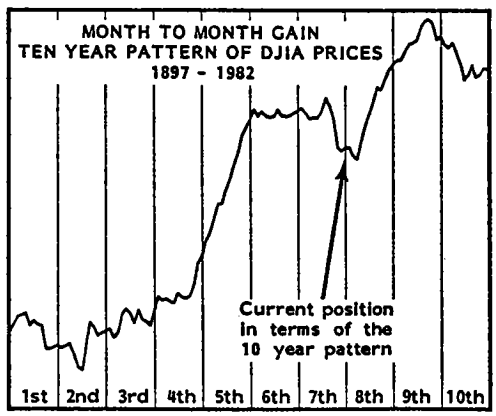
Answer: Currently, the Dow yields 3.7%, still a rather low figure. Based on the current $70.72 total Dow dividend, if the Dow was to go back to the extreme overvaluation area (to 3%), it would rise to 2354. Conversely, if the Dow was to go down to bear market bottom territory (to 6%), it would drop to 1177.

Question: Many analysts are now pointing to the so-called "decennial pattern," and they are saying that that pattern suggests a bullish 1988. How do you feel about that?

Answer: The decennial pattern is based on the thesis (advanced by Edgar Lawrence Smith during the '30s) that over the years market patterns tend to repeat on a 10-year cycle basis. Thus, for example, the decennial pattern suggests that years ending in 7 (i.e., 1907, 1917, 1927, 1937, 1947, etc.) have tended to be poor years while years ending in 8 (i.e., 1938, 1948, 1958, 1968, etc.) have tended to be good years.

There are many coincidences in the stock market, and in my opinion the decennial pattern is probably one of them. For instance, in studying all the years ending in 8 (in terms of the Dow) since 1888 -- and there were 10 of them -- I note the following: 1888 was a mildly good year, 1948 ended as a down year, and 1978 was also a down year. Personally, I wouldn't want to bet the barn on those odds.

For the edification of subscribers, however, I am including this chart, which is a composite of all the decades between 1900 and 1979. Note that the "8" year composite has a strong bullish bias. We'll see if 1988 can join the parade (chart courtesy of Growth Fund Research, Box 6600, Rapid City, SD 57709).



However, as to the decennial pattern, I think it is far more important to consider whether any given year falls within the sway of a bull or a bear market. If a bull market is in force, the odds are good that any given year within that bull market will be an up year. The opposite is true if a given year falls within a bear market.

And just to confuse the issue, ponder this item (courtesy of Yale Hirsch's *Smart Money):* "Historically, the market has lost ground in the last year of every 'lame duck' president's second term since Andrew Jackson in 1835." And as you are well aware, 1988 is the last year of a lame duck's second term.

Question: This being the last year before a presidential election, isn't it par for the course for the Fed to open the monetary spigots and thus gun the economy in time to help the incumbent party prior to the election (after all, Reagan did pick Greenspan for Fed chief)?

Answer: Yes, that's been the pattern in the past, and I'm sure the Republicans are waiting for that to happen in the period ahead. But I believe the Fed is worried about the dollar as well as being worried about a recession. Therefore, they could be very hesitant about delivering the usual pre-election monetary manipulations here in '88.

Question: What do you make of the wild moves in this market?

Answer: Study the action following any crash and you will see that volatility increases tremendously. A crash represents a violent change in market mood and investors' perceptions. Did you ever watch a kind of boring prize fight, when suddenly one fighter lands a jarring right to the chin of his oppenent. The oppenent goes down, then rises at the count of six and starts swinging. Suddenly, the shock of the knockdown produces a totally different fight. The fight becomes volatile. The guy who was knocked down is trying to come back, and his opponent is trying to end it. The boring battle turns into a sizzler.

That's about what happens in the market after a crash. The equilibrium is broken, and market is shocked, opposing forces fight for control and volatility rises.

Remember this also. Today there is tremendous confusion and disagreement about the future. Henry Kaufman thinks T-bonds will yield 11% by the end of '88. Others believe yields will drop to 8%. US consumers are slowing their buying while manufacturers are finding business increasing. The Southwest is in a slump while

New England is dealing with a labor shortage. The dollar has collapsed -- some think we've seen the bottom, others believe the dollar will drop to 100 yen. Many analysts believe 1988 will be a good year. Others are flatly saying we're in recession. Some analysts are going public with predictions of new Dow highs; others are saying that we'll see 1300 before the year is out.

All of this militates toward extreme volatility. Add to these conflicting opinions the greatest market smash in history and you have the ingredients for market pandemonium. And that's about what we've been seeing ever since late October.

Question: Russell, your actual timing of bull and bear markets over the last three decades has been pretty good. In view of that record, why don't you recommend more trading in Dow Theory Letters?

Answer: Let me tell you something. The advisory business is a very tough business. It's very competitive, and it's very difficult for anyone to last in this business. Because of this, a lot of advisories try very hard to do the impossible, the impossible being to make successful speculators and traders out of their subscribers.

Why is it so difficult to make successful traders out of subscribers? It's difficult becauses very, *very few advisors are able to make correct calls over any considerable period of time.* In other words, what happens is that the eager advisors make mistakes, and when that happens, their subscribers take a bath -- and then, alas, the subscribers leave and the ambitious advisor fades into Wall Street history.

Frankly, I can't think of ANY advisors (and believe me, I read a lot of them) who have been successful in calling the secondary and minor turns over say a 10-year period. What usually happens is that an advisor makes a series of good calls. He develops a big following, and he enjoys publicity and guru status in the various newspapers and magazines. And then -- the advisor makes a horrible mistake, a major mis-call, and it's a slow fade-out. Finally, the advisor becomes just another one of the gang. He becomes just another "human being" (as opposed to genius) who is sometimes right and sometimes wrong.

What did I learn in studying the ups and downs of dozens and dozens of advisors? I learned that it's great to be a guru, it's great to be written up as "the guy who calls all the turns." But it's also a fool's paradise, because in the end you're trying to deliver more than it's reasonably possible for anyone to deliver.

So I learned that the best thing I can do for my subscribers is to keep them invested during a bull market and keep them out of a bear market. Over the long run that can be an extremely profitable procedure, and if you follow that procedure you'll fare better than 90% of the people who "play" the market.

A big bull market is the money-maker, the true fortune-builder. A big bear market is the killer, the ultimate asset-destroyer. The secondary and minor movements in both bull and bear markets are the sleep-losers because they're always hard to identify and difficult to operate in. Remember that and you'll be way ahead of the game.

INVESTMENT POSITION: One of the questions I get from new subscribers is, "Do you recommend specific stocks?" And the answer is yes, I do recommend specific stocks -- but only when I want subscribers to buy those stocks. The time when I want my subscribers to load up with stocks is when a bull market is in force (particularly, early in a new bull market). We're not there now -- thus, any stocks I talk about here will simply be to make a point.

Bull or bear market, however, I continue to monitor my stock charts. In a bear market (as now), I always look to see what stocks (1) are advancing above their 200-day moving averages, and (2) whether those same stocks are showing superior relative strength. If a stock can do those two things in a bear market, it is an outstanding stock.

Right now the D-J Industrial Average is acting better than the rest of the market. With that in mind, which of the 30 Dow stocks fulfill my two technical criteria? Here they are: Bethlehem Steel, Goodyear, Texaco, USX Corp., with Aluminum Co. of Amer. in this favored group if it can rise above 50 1/2 and International Paper in the group if it can rise to 45 or better. What's interesting about this group? They're all in capital goods.

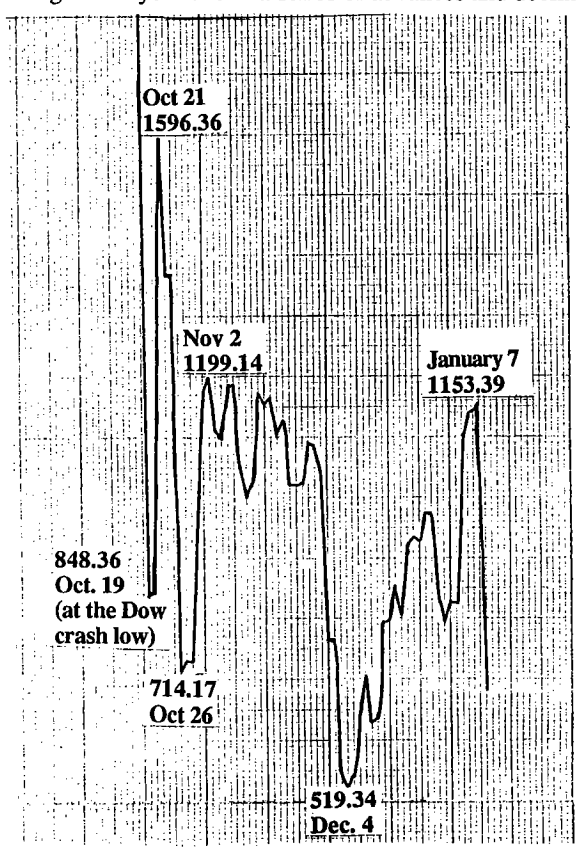
Conclusion: The initial trouble in the economy is going to come from the consumer group. What strength there is in this market is arising from the capital good stocks; manufacturing will be the last area to suffer as the bear market goes on. The reason for this -- the cheaper dollar will give US manufacturers some advantage in international sales while at the same time the debt-strapped US consumer is pulling in his horns. In time, however, our overseas markets will succumb to the bear, and both our imports and exports will decline.

The mystery -- the poor action of the supposedly defensive utility stocks. My guess: Lower energy consumption next year as the bear takes hold in the economy.

As far as the bear is concerned, he's still very much master of the box.

DOWPOW: DowPow (which stands for Dow power) is my proprietary index of the Dow adjusted for the daily advances and declines. To illustrate the use of DowPow, let's consider two trading days. On the first day the Dow rises 10 points accompanied by 1200 advances and 200 declines on the NYSE. The next day the Dow rises 20 points accompanied by 600 advances and 550 declines. The first day is going to show up on DowPow as considerably stronger than the second day. Obviously the difference is the far superior upside breadth on the first day even though the Dow gained twice as many points on the second day.

So what does DowPow do for us? First, we must remember that the Averages always move in a series of advances and declines. If



the advances are greater than the declines the market tends to rise. If the declines are greater than the advances the market tends to decline. But over a period of time the real action of the market may be masked by deceptive action in the blue-chip stocks (i.e., the Dow). So here's what DowPow does for us: It removes the Dow's disguise and shows us the Dow adjusted for the power (or lack thereof) in the rest of the market.

Frankly, I am fascinated by the action of DowPow. Following the October 19 crash low, DowPow surged to an October 21 value of 1596.36. Next, a series of lower highs and lower lows took DowPow down to a December 4 low of 519.34. This was probably the actual 1987 low day for the majority of stocks on the NYSE.

Here's the update on Dowpow. On January 7 DowPow climbed to 1153.39 as you can see on the chart. Yet, as of January 7 DowPow was continuing in its bearish pattern of tracing out lower peaks and lower lows. Frankly, I thought that this bearish pattern would be reversed and that on January 8 we might see DowPow finally rally above a previous peak (the peak being the November 2 high of 1199.14). But the weakness that DowPow has been displaying so clearly burst upon the market on January 8 as DowPow plunged 463 points to break under its recent December 29 low. The drop took DowPow to within shooting distance of its December 4 bear market low.

Conclusion: As of this writing DowPow continues to trace out its bearish pattern -- a pattern of declining tops and declining bottoms. No other indicator that I have seen shows so clearly the market's weakness on the rallies compared with its strength on the declines.

UTILITIES: "Should I hold utility stocks in a bear market?" The answer is that utilities may do better than the rest of the market during bull market corrections; in a primary bear market (as now), utilities tend to go with the trend.

I am including this weekly chart of the D-J Utility Average (courtesy of my friends at Investment Quality Trends here in La Jolla). The chart is particularly interesting for two reasons. (1) Note that the great 1949-66 bull market took the Utilities to a peak (April 1965) of 163.32. The Utilities then went into a bear market that by September 1973 saw them at a low of 57.93. That represented a reduction of 64% of their value. Now I'd call that a major loss.

(2) Note that there are yield lines drawn in on this chart. Based on past history when the Utility Average is in the 3% yield zone they are overvalued. When they are in the 12% yield zone they are undervalued. The 6% yield zone represents average value.

The Utility Average topped out in January 1987. Therefore they never really participated in the speculative madness of 1987 in that their yields never got below 6%. Note also that in 1974 and again in 1982 (and almost in 1984) the Utility yields got down to the 12% undervalued level.

What I think this chart may be telling us is that the Utilities never went wild on the upside, and therefore they just might be more stable on the downside in this bear market. I say that simply because the Utility Average, at a value of around 110 (based on today's dividends), would be back in the 12% undervalued range.

But (as you can readily see) that's hardly a recommendation to buy the utilities. As a point of interest, almost every utility stock is now displaying poor relative strength. Obviously, there's something bothering investors about the utility group, and I don't think it is the prospect of higher interest rates.

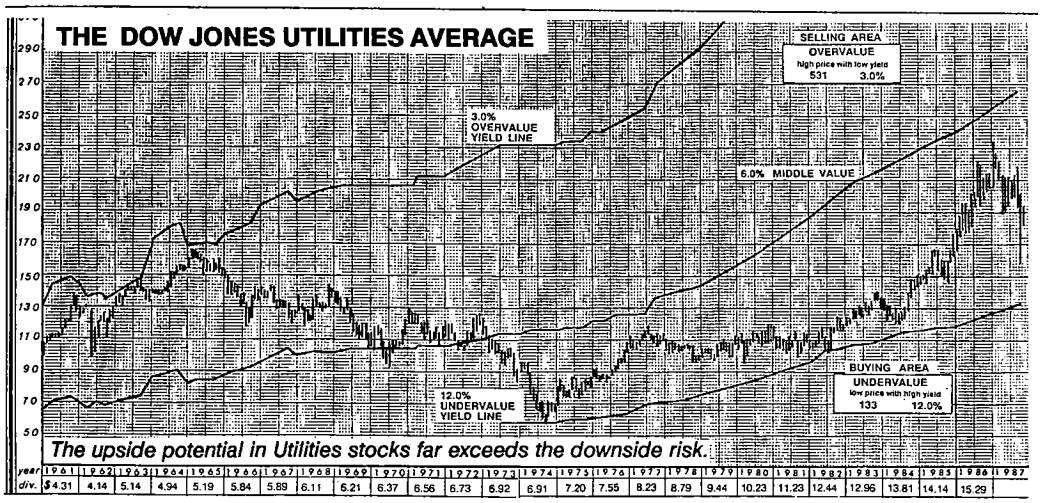
AH, PERFECTION: As we start the new year I'm going to repeat what I believe was the most popular "extra" that I have ever published in these Letters. I'm referring to my discussion of "the perfect business." I first published this list about a dozen years ago, and then I republished it in Letter 881. But seldom does a month go by when I don't get a few letters from subscribers who have heard about the perfect list, and would like to see it published again.

I once asked a friend, a prominent New York business lawyer, "In all your years of experience, what is the best business you have ever come across?" Without hesitation he answered, "I have a client who manufactures a chemical used in synthetic rubber. This chemical is absolutely vital to the manufacture of rubber. But it is used in very small quantities and only in absolutely super-refined form.

"My client is the only one who manufactures this chemical. He therefore has a virtual monopoly since this chemical is difficult to manufacture and not enough of it is used to warrant any other companies competing with him. Furthermore, since the rubber companies need only small quantities of this chemical, they don't particularly care what they pay for it -- as long as it meets their very demanding specifications. My client is a milionaire many times over. His business," said the attorney, "is the best I have ever come across." I never forgot that story.

When I was a young man just out of college my father gave me a few of his personal tidbits of advice. He had been in the paper manufacturing business; he had been an assistant to Mr. Sam Bloomingdale (of Bloomingdale's department stores), he had been in construction (he was a civil engineer), and he was an expert in real estate management.

Here's what Dad told me. "Stay out of the retail business; the hours are too long and you're dealing with every variable under the sun. Stay out of real estate; when hard times arrive it comes to a dead stop and then unravels. Furthermore, real estate is illiquid. Get into manufacturing -- make something people can use. And make something you can sell to the world. But if you're really interested in making money, get into the money business. It's clean, you can get rid of your inventory in a minute, and it never goes out of style."


THE DOW JONES UTILITIES AVERAGE
SELLING AREA
OVERVALUE
high price with low yield
531 3.0%
3.0% OVERVALUE YIELD LINE
6.0% MIDDLE VALUE
BUYING AREA
UNDERVALUE
low price with high yield
133 12.0%
12.0% UNDERVALUE YIELD LINE
The upside potential in Utilities stocks far exceeds the downside risk.
year 1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987
div. $4.31 4.14 5.14 4.94 5.19 5.84 5.89 6.11 6.21 6.37 6.56 6.73 6.92 6.91 7.20 7.55 8.23 8.79 9.44 10.23 11.23 12.44 12.96 13.81 14.14 15.29

So much for Dad's wisdom (which was obviously tainted by the Great Depression). For my own part, I've been in a number of businesses -- from textiles to book publishing to owning a night club to the advisory business. Along the way I developed this list of criteria which go to make up the mythical PERFECT BUSINESS. Now obviously, the ideal business does not exist and never will. But if you start a business or go into someone else's business or want to buy a business, this list may help you. The more of these criteria your new business or new job possesses, the better off you'll be.

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(1) The ideal business sells the world, rather than a single neighborhood or a single city (in other words, it has an unlimited market).

(2) The ideal business offers a product which has an "inelastic demand." That means that people need it -- almost regardless of price.

(3) The ideal business sells a product which cannot be easily substituted. It cannot be copied or reproduced. This means that it is an original, or something that can be copyrighted or patented or is damnably difficult to reproduce.

(4) The ideal business has minimal labor requirements (i.e., the fewer personnel the better).

(5) The ideal business boasts low overhead. It does not need an expensive location; it does not need large amounts of electricity, advertising, legal advice, inventory, etc.

(6) The ideal business does not require large cash outlays or large investments in equipment. In other words, it does not tie up your capital.

(7) The ideal business is a business that has cash billings (as against terms). In other words, it does not tie up your money with extended credit arrangements.

(8) The ideal business is relatively free of all kinds of government and industry regulations and strictures (and if you're in business now, you know only too well what I mean).

(9) The ideal business is portable. You can take it (and yourself) anywhere you want -- Florida, California, Monte Carlo, the Canary Islands.

(10) Here's a crucial but oft overlooked one -- the ideal business is one that satisfies your intellectual (and often emotional) needs.

(11) Here another important one. The ideal business leaves you with free time. In other words, it doesn't require your labor and attention 16, 12 or even 8 hours a day.

That's it. If you use this list, it may help you cut through a lot of nonsense and hypocrisy and wishes and dreams regarding what you are looking for. None of us own or work for an ideal business. But it's nice to know what we to look for and how close we are (in our current situation) to the ideal business.

NOTES & QUOTES: At the end of this month the Super Bowl comes to -- **San Diego**. So if you want to see the town where I hang out, turn on your TV sets on January 31. How about the weather? I've always said that San Diego is a great town to be in during a bear market. Why? Because nobody ever froze to death here. As far as temperature, the coldest pro football game ever played in this town was seen (felt) in the winter of 1978 on a day when the Chargers played the Steelers. The low temperature for that day -- 48 degrees. That's about as bad as it gets here, even in winter.

When I first moved to SD back in 1961 this was a little town with a population of near 300,000. SD had two Chinese restuarants, a few bowling alleys, one art theater, three book stores, a single passable shopping center, a fine zoo and last but not least -- the US Navy (Pacific Fleet Headquarters). The town was a bit hokey in those days, but otherwise it was an undiscovered paradise. Since then the rest of the country seems to have discovered SD -- boy, have they discovered it.

Now SD's population is over 1.1 million and growing like crazy. Every third block has an Asiatic, French, or Mexican restaurant, shopping centers abound, and SD has become a legitimate theater center. We're tops in medicine and medical research, our zoo is world-class, we've got Dennis Conner and the San Diego Yacht Club, we've got two ball clubs (Chargers and Padres) who can't win anything important, we've got some art and a few serious art galleries (mighty few) and we've got traffic coming out of our ears. But I love this town and sincerely consider it the finest in the US, all things considered. Finally, we even boast a few good restaurants here -- not NYC caliber but good. And oh yeah, we still have the best weather in the nation if not the world. Folklore has it that San Diego is the only place in the nation where you can plan an outdoor picnic three months ahead and not worry about the weather.

* *

Newsweek's cover story last week heralded the end of greed and the demise of the Yuppie generation. If so, it's time for the ultimate Yuppie joke (thanks to friend Howard Ruff for this one). A yuppie stockbroker who lost most of his customers on Black Monday consoled himself by taking a spin in his new BMW. The poor fellow got a flat on the freeway. He stopped, and quickly opened the door to survey the damage. A passing car tore the door off along with the broker's left arm.

A police car pulled up and found the broker screaming hysterically, "My BMW, my BMW!" The amazed cop said, "Are you crazy, man? Forget the car -- your left arm has been torn off." Upon which the broker started shouting, "My Rolex, my Rolex!"

* *

Numbers: Prime Minister Margaret Thatcher (a grocer's daughter) has now held that position for going-on nine years, the longest such tenure in Britain this century. ... San Diego County is rapidly becoming California's car-theft champion. Through November of last year, the county has had 28,385 cars stolen, up 40% from the year before. The car stolen most often -- Toyota Corollas and Celicas. Why? Cheap locks.

* *

More numbers: There are still 17,000 US servicemen missing and unaccounted for from the Vietnam War. One organization offers $2.5 million for the return of any MIA -- alive. ... 25% of all immigrants to the US settle in California. ... 62% of LA's kindergarten children are now Hispanic. ... NYC has 11,789 taxis driven in shifts by 39,000 drivers. Gotham also has 30,600 cops.

* *

Japan: Nihon Kesai Shimbun, Japan's leading financial newspaper, comes out in a morning and evening edition. Between the two they sell 2.7 million papers a day (Wall St. Journal sells 2 million a day). ... Nippon Tel. and Tel.'s capitalization is $290 billion or 10% of the value of the entire Tokyo Stock Exchange (and larger than the whole West German Stock market). NTT's price/earnings ratio is 250.

* *

Win/Loss Column: Winner: Heavyweight champion Mike Tyson, who just signed with HBO for six fights. The six fights will earn "Iron Mike" $26.5 million. Loser: Famed Texas Heart Surgeon Denton Cooley, who has filed under the federal bankruptcy law. Assets, $44 million. Debts, $99.4 million. Cooley, says his lawyer, is a victim of Houston's real estate miseries.

* *

From a *US News and World Report* interview with the brilliant former W. German Chancellor, Helmut Schmidt, now publisher of *Die Zeit*: " ... Problems will mount. By 1989, the foreign debt of the US will exceed half a trillion dollars. At an interest rate of 8%, you would need to transfer $40 billion to the rest of the world on top of your trade deficit. There are two dangers here: First, those who hold American IOU's will try to swap them by buying up American factories, real estate, and shares. Americans will resent this, with political repercussions -- more regarding the Japanese than the Germans. However, if the swap does not occur and you have to pay the interest, there is no other way than to broaden the

money supply -- that is, print the interest. Therefore, I expect new dollar inflation as well as a world recession. So 1989 will be a dramatic year for the new President. Whether he's a Republican or a Democrat makes no great difference."

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Dem Warm-Up: Presidential candidate Paul Simon says that if new taxes are needed, he'd impose an income-tax surcharge on "the wealthiest of Americans" and by that he means those earning over $100,000. Why not, they're only 1% of the US population, and that's not where the votes are.

GOLD: I keep getting letters asking how to buy gold. Buy gold coins from an honest local coin dealer or buy it from a known gold source. Here are a few sources: Benham Certified Metals (800) 447 4653 or (415) 858 3609; Investment Rarities (800) 328 1860 or (612) 853 0700 ; Blanchard & Co. (800) 535 7633 or (504) 837 3010.

Which coins to buy? Buy any of the bullion gold coins, and compare prices with a few sources if you're suspicious of a dealer's price. The coins will go for a small premium over actual gold content in the case of krugerrands -- up to 5% premium for Amer. eagles and often more for Chinese Pandas. I also like Maple Leafs and Mexican 50 peso pieces. They're all gold, and I personally buy assortments. I also advocate buying a fixed dollar amount of gold each month -- whatever amount you feel comfortable with.

If I weren't in this business, I probably wouldn't even look at the price of gold. It will fluctuate, it will rally, it will sell off. In the end, it will outlast everything you have from your stocks to your bonds to your Mercedes to your home. One thing is certain -- gold will outlast the idiots in Congress who have been destroying what was once the most wanted currency in the world.

If we have inflation, gold will keep up with inflation in terms of purchasing power. If we have deflation my thought is that there is currently so much debt in the US (and world) that we would probably see a buckling of the financial system. In that case, we would also want to hold gold.

Today you read a lot of nonsense about "too much gold being mined." But compared to the amount of dollars being produced and the amount of debt that is being produced, the amount of new gold being mined each year is a pittance.

Of all items traded, held or invested in, gold is subject to the most emotion. People love it, people hate it. Don't do either. Treat it as real money and be glad you're allowed to own it.

Remember, when dictators take over they outlaw three things: (1) a free press, (2) arms, (3) gold. A free press exposes corruption, arms allow the citizenry to defend themselves from corrupt governments and criminals, and gold (the international money) allows one to get out of the country when all else fails.

The trend of gold bullion is bullish. The 144-day (exponential) moving average for gold is 468. Gold would have to drop to 456 to render an initial point & figure sell signal. Gold shares have never come back to their 1980 highs. They are suffering from over-valuation, (2) minuscule yields. Remember what I said -- in this bear market the operative word is going to be "income." Gold shares don't provide it. Nor do they provide the safety of bullion in your lock-box.

LATE NOTES: This bear market is producing its share of records. So far it has come up with the three greatest Dow drops (in points) in stock market history. The first was the October 19 drop of 508 points. The second was the 156.83 point drop of October 26. The third was the 140.58 point drop of January 8.

The huge bear market losses have prompted a federal task force to suggest limited moves for stocks and the stock market, in my mind an utterly stupid and totally useless idea. To whatever level stocks are heading (in this or any bull or bear market) they are inevitably going to go -- it's just a matter of how they get there and the less goverment interference and manipulation the better. Thought: If this were a bull market and the huge moves were on the upside would the task force be recommending limited moves? You can bet your bottom dollar they would not.

Since the October 19 crash low of 1738.74 the Dow has been as high as 2051.89, a level recorded on January 7. This represents a total Dow range of 313 points. The January 8 "mini-crash" wiped out roughly 45% of all the gains registered since October 19 — erased them in a single day.

Another way of looking at the situation is this: As of January 11 the Dow was up 173 points (or only 9.9%) from its October 19 crash low. That's not much progress considering that we are 56 trading days away from the worst crash in market history. In comparison, 56 days after the crash low in 1929 the Dow was up 25.7% -- hardly a comforting comparison.

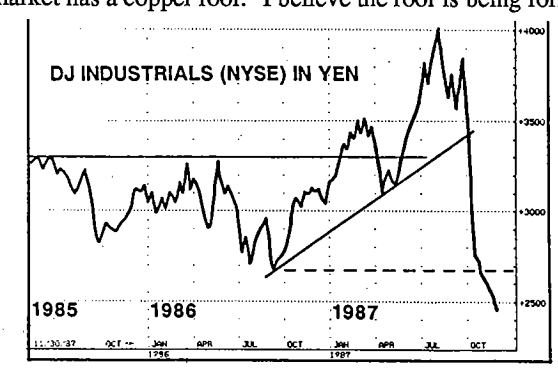
Judging from what we read in the newspapers, all's well on the economic front. Clearly, the market thinks otherwise. What's the market looking at? My feeling is that the market is looking at Washington, where it sees a bumbling President and Congress that produced absolutely no progress on the budget deficits (with the spectre of a larger deficit in 1988 than '87 and almost certainly higher taxes in '89). Furthermore, I think the market foresees major trouble ahead as US consumers pull in their horns and cut back on their buying -- a process which will ultimately affect manufacturing.

Ed Hyman of *C.J. Lawrence* in his latest mailing notes: "No growth in monetary reserves, no growth in M-1. Over the past 8 weeks, M-1 has declined $16.2 billion. Over the past year M-1 growth has slowed from 18.5% to 2.5% -- the sharpest deceleration on record. M-1's year-over-year growth of 2.5% is the lowest since 1967." (Russell says, this could represent the Fed's attempt to defend the dollar by making dollars scarcer, but decelerating M-1 will be bearish for the economy).

Despite what you may have been hearing, consumers have been cutting back sharply on purchases. *Business Week* (Jan. 18) states: "Excluding services, consumer purchases of goods in the fourth quarter fell considerably. That swelled retailers' ratio of inventories to sales. In real terms, after adjusting for changing prices, the ratio in October rose to the highest level since the Commerce Dept. began keeping records back in 1967." (Russell says, no wonder the stores have been offering discounts and sales -- they're up to their necks in inventory. This will slow manufacturing as 1988 goes along).

How much longer can we expect foreign buying of US securities? The answer is not much longer unless the dollar stabilizes or turns up. This chart gives you some idea of the losses sustained by the Japanese who've purchased US stocks in the past few years. They obviously can't take much more of this (and remember, this is still a bear market).

Copper has been in a wild parabolic (exponential) rise, and I believe it's topping out. The old Wall Street adage states, "Every bull market has a copper roof." I believe the roof is being formed.



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